BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
CAL-WEST BUSINESS SERVICES, INC.)

Appearances:

For Appellant: Kenneth W. Hufford
Certified Public Accountant

For Respondent: John D. Schell
Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of-the Franchise Tax Board on the protest of Cal-West Business Services, Inc., against a proposed assessment of additional franchise tax in the amount of $457.72 for the income year ended March 31, 1967.

The question presented for decision is whether respondent properly classified appellant Cal-West Business Services, Inc., as a financial corporation 'within the meaning of section 23183 of the Revenue and Taxation Code, thereby making it taxable at the rate applicable to banks and financial corporations rather than at the lesser rate applicable to general corporations.

Appellant, a California corporation located in Lafayette, Contra Costa County, was incorporated on May 29, 1963. Its articles of incorporation state:

> The specific business in which the corporation is primarily to engage is to purchase accounts receivable from retail and wholesale merchants, bill for and collect the same and to furnish

> miscellaneous services to merchants in connection with their credit practices;...

Pursuant to contracts with 25 merchants in Contra Costa County and 27 outside the county, during the year under appeal, appellant purchased their accounts receivable at a 5.5 percent discount. To finance the purchases, appellant borrowed money from a bank and secured the loans through use of the receivables as collateral. Appellant borrowed the money at a rate higher than its discount rate. The accounts receivable generally represented small consumer merchandise purchases, such as drugs, cosmetics, camera supplies, clothing, flowers and hardware. The average receivable acquired for the year ended March 31, 1967, was $31.50. The amount of receivables outstanding at the end of the year on appeal was $583,247.94. Bad debt losses steadily increased until they reached $24,609 for the year ended March 31, 1968.

To determine whether a particular account would be acquired with or without recourse, appellant conducted a credit search with respect to the credit standing of the merchant's customer. If appellant approved the customer's credit, the account was purchased without recourse. Approximately one-half of the accounts were purchased without recourse during the year on appeal. Appellant did the bookkeeping in connection with the receivables, billed on the merchant's own statement forms, kept credit records and did the collecting. Appellant's telephone number end post office box number were listed on the billing, but appellant billed in the merchant's name, and the customers were not informed of the assignment of the receivables. Appellant wrote correspondence, served delinquent notices, and handled telephone calls from customers concerning credit and other matters.. Where accounts were not paid in full within 30 days, appellant charged a monthly service fee on the unpaid balance, usually 1.5 percent. The agreement between the merchant and appellant provided that the amount by which appellant discounted the receivables was retained as its compensation for services. In addition to income from the discounts and the service charges, appellant received reimbursement for the cost of searches performed by credit bureaus and a small amount of income from such miscellaneous services as providing mailing lists. Appellant's business has steadily expanded.

For the four consecutive years indicated below, appellant9 gross income, derived from its contracts with the merchants, was as follows:

	Income Years Ended				
Source	3/31/64	3/31/65	3/31/66	3/31/67	Total
5.5% discount	$39,652	$70,282	$ 88,309	$103,193	$301,436
1.5% service charge	7,361	26,465	499957	78,177	161,960
Credit Work	388	1,071	1,059	1,373	3,891
Misc. Services	174	177	705	1.615	2,671
	$47,575	$97,995	$140,030	$184,358	$469,958

In computing its California franchise tax liability, appellant used the rate applicable to general corporations. Respondent determined that appellant was a financial corporation, and thus subject to tax at the same rate as banks, with offsets for personal property taxes and certain other taxes and fees which banks do not pay. Appellant protested the resulting proposed additional assessment, and respondent's denial of the protest gave rise to this appeal.

The "financial corporation" classification (Rev.& Tax. Code, § 23183 et seq.) was created by the Legislature to comply with the federal provision (12 U.S.C.A. § 548) prohibiting discrimination between national banks and other financial corporations. (Crown Finance Corp. v. McColgan, 23 Cal. 2d 280 [144 P.2d 331]; Marble Mortgage Co. v. Franchise Tax Board, 241 Cal, App. 2d 26[50 Cal. Rptr. 345].) The term is not defined in the statute. However, the courts have held that a financial corporation is one which deals in money or moneyed capital as opposed to other commodities (The Morris Plan Co. v. Johnson, 37 Cal. App. 2d 621 [100 P.2d 4o?)], and which is in substantial competition with national banks (Crown Finance Corn. v. McColgan, supra).

Appellant contended that it was primarily rendering business services to small retail merchants, rather than dealing in money or moneyed capital,. and that these services included bookkeeping, recording, checking credit and billing services. Appellant maintained that it acted as an extension of the merchants'

own offices with respect to the processing of accounts receivable. In our opinion, however, appellant was primarily dealing in money or moneyed capital, as opposed to its claim of principally providing services. It did perform some services for the merchants, but its primary activity was the purchasing and the processing of accounts receivable. This was a financial operation substantially similar to the acquisition of conditional sales contracts at a discount and the subsequent receipt of revenue from such contracts, which had been regarded as a financial activity. (Cf. Crown Finance Corp. v. McColgan, supra, 23 Cal. 2d 280 [144 P.2d 331].) The clerical, book-keeping, billing, record keeping, credit and collection activities were business practices essential to success when engaged in the business of purchasing accounts receivable and were not merely services performed for the merchants.

Appellant also. contended it was not in sub-. stantial competition with national banks in its locality. However, in one of the five letters from local banks submitted by appellant, the bank admitted it offered similar services although it said it did not know of a single account appellant had that it would aggressively seek.

Another bank responded:

> ... as a bank we would not be interested in purchasing the type's of receivables from the clients you now have. Our inclination would be to decline loans to such businesses unless the principals were substantial enough to guaranty any credit that might be extended to the business. In the case of most of your clients this is not so.

It is thus apparent that although their terms and conditions were more stringent, some national banks in appellant's locality were interested in discounting merchants' accounts receivable. As was stated in Crown Finance Corp. v. McColgan, supra, at page 287:

> It is not logical to say that where two concerns are engaged in trading in a similar commodity (money and conditional sales contracts in the instant case) they are not in competition because one offers

more favorable terms and prices than the other.

It is also well established that national banks discount conditional sales contracts, a substantially similar activity (Crown Finance Corp. v. McColgan, supra, 23 Cal. 2d 280 [144 P.2d 331]; The Morris Plan Co. v. Johnson, supra, 37 Cal. App. 2d 621 [100 P.2d 493]). Furthermore, many national banks discount accounts receivable by the credit card method. (Cf. Appeal of the Diners' Club, Inc., Cal. St. Bd. of Equal., Sept. 1, 1967.)

During the year on appeal, appellant, in order to produce the reported income of $103,193 at the 5.5 percent discount rate, would have purchased accounts receivable in excess of $1,800,000. This clearly established that appellant's financial activities were in substantial competition with the national banks.

For the above reasons we must sustain respondent's action in this matter.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Cal-West Business Services, Inc., against a proposed assessment of additional franchise tax in the amount of $457.72 for the income year ended March 31, 1967, be and the same is hereby sustained.

Done at Sacramento, California, this 6th day of November, 1970, by the State Board of Equalization.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member

ATTEST: _____, Secretary